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Federal Building and Loan Association v. Bert E. Tidwell, Barbara Beth Tidwell, His Wife, Frank Lewis, Claron Bailey, Doing Business as Claron Bailey Dry Wall, Utah Sand and Gavel Company, a Utah Corporation, and R. Blaine Hicks, Doing Business As Hicks Electric Company : Respondent's Brief

Utah Supreme Court

IN THE SUPREME COURT OF THE STATE OF UTAH

FEDERAL BUILDING AND LOAN ASSOCIATION, a corporation of Utah,

Plaintiff and Appellant

vs.

BERT E. TIDWELL, BARBARA BETH TIDWELL, his wife, FRANK LEWIS, CLARON BAILEY, doing business as CLARON BAILEY DRY WALL, UTAH SAND AND GRAVEL COMPANY, a Utah Corporation, and R. BLAINE HICKS doing business as HICKS ELECTRIC COMPANY,

Defendants and Respondents.

Case No. 11168

RESPONDENT'S BRIEF

Appeal from a Judgment of Dismissal of the District Court of Salt Lake County
Honorable Stewart M. Hanson, Judge

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STATEMENT OF THE CASE

This action involves a priority between a construction mortgage loan lender and a lien claimant. There is no issue as to the validity of either the mortgage or the lien claim.

DISPOSITION OF THE CASE BY THE LOWER COURT

The Lower Court granted Respondent Claron Bailey's Motion for Summary Judgment as prayed for in his Counterclaim, as supported by his Motion for Summary

Judgment (R-33 and 34), Affidavit (R-36 and 37) and Appellant's Answers to Interrogatories (R-28-32).

RELIEF SOUGHT ON APPEAL

Respondent is seeking affirmance of the Judgment granted by Third Judicial District Court of Salt Lake County, Utah, where Respondent's Mechanic's, Lien was adjudged first and prior to the mortgage of the Appellant, awarding a Judgment in favor of the Respondent.

STATEMENT OF FACTS

Respondent adopts Appellant's Statement of Facts, except as modified and added thereto in Respondent's Argument.

ARGUMENT

POINT I

APPELLANT IS ESTOPPED FROM ASSERTING THAT ITS PRIOR RECORDED CONSTRUCTION MORTGAGE TAKES PRIORITY OVER RESPONDENT'S MECHANIC'S LIEN FOR MONEY ADVANCED BEFORE THE ACCRUAL OF THE LIEN.

Appellant is taking the position in line with the general rule of law that a prior recorded construction mortgage takes priority over a subsequently recorded mechanic's lien, unless the Mortgagee is estopped from asserting its priority. It cites the Utah case of *Utah Savings & Loan Association vs. Mecham,* 11 Utah 2d 164, 356 P2d 881, rehearing 12 Utah 2d 35, 366 P2d 598, as authority that under the facts of the case before the Court, the Appellant is not estopped from asserting its priority. Respondent alleges that the Mecham case should be given a much broader interpretation, for in that case, the Defendants, being numerous lien holders, contended that under the terms of the mortgage, the mortgagee was not

obligated to advance the monies thereunder and the lien claimants should have priority over all sums advanced to mechanics after work was commenced. This Court stated:

> "The mortgages herein question have priority over the liens of the defndants for the monies actually advanced thereunder, unless Plaintiff is in some way estopped from asserting his priority. There is no doubt that a mortgagee may be estopped from claiming a mechanic's lien, however, in order to establish an estoppel against a mortgagee, the lien claimant must show some concealment, misrepresentation, act or declaration by the mortgagee upon which the lien holder properly relied and by which he was induced to act differently than he would otherwise have acted."

In Appellant's Answer to Respondent's Interrogatories, we find the following facts (R 28-32): That on the 5th day of July, 1966, a mortgage note, real estate mortgage and disbursement agreement were entered into between the Apellant (Mortgagee) and Defendants, Bert E. Tidwell and Barbara Beth Tidwell, his wife. The agreement provided that $29,000 would be loaned to the Tidwells for the purpose of a construction loan and the amount would be placed in a special account entitled "Incomplete Building Loan Account No.....". The Mortgagee may, at its option, pay money from this account to any of the mortgagors, contractors, materialmen or laborers who furnished materials or performed labor for the construction or improvements of the premises. The Mortgagors were to commence work within 30 days and complete the construction within eight months, or on or before the 5th day of March, 1967. The Mortgagee had the option whether to require satisfactory lien waivers covering work done and materials furnished for the im-

provements, before any amounts could be disbursed, but the money must be used exclusively to pay the cost of labor and material. Should the Mortgagors default in the performance of any of the covenants, or should work cease for a period of 15 days or should any lien be recorded against the property, the Mortgagee may, at its option, declare all indebtedness incurred by the mortgage, immediately due and payable, withdraw all sums from the account and the Mortgagee would be released from all obligations under the agreement.

Further, Respondent quotes from Appellant's Answer to Interrogatories, as follows:

> "2. State in detail how the Defendant Tidwell failed and refused to comply with the said conditions for disbursements.
>
> ANSWER: Defendant Tidwell refused and declined to furnish satisfactory lien waivers, covering work done or materials furnished after demand by plaintiff . . .
>
> 3. State the amount of money which the plaintiff advanced to Tidwell under the Promissory Note and Mortgage and the amount of money still held by plaintiff under the original terms of the Note and Mortgage.
>
> ANSWER: Plaintiff advanced the sum of $11,600 to Defendant Tidwell and retained the balance of the loan proceeds in the "Incompleted Building Loan Account" until the commencement of this action, at which time the loan was considered matured and the incomplete loan account dissolved.
>
> 4. Please state the date when the plaintiff first learned that the Defendant Tidwell became in financial difficulty and when he failed to comply with the conditions for disbursements.

ANSWER: Plaintiff was first suspicious of Defendant Tidwells' financial solvency beginning in the first few months of 1967 and as a direct result of Tidwell's refusal to furnish accounting information with respect to loan proceeds and lien waivers with respect to labor and material furnished to the subject property.

5. Please state what action the plaintiff took in regards to Paragraph 4 above, and whether Tidwell was told by plaintiff to go in and finish the house.

ANSWER: Plaintiff made clear to Defendant Tidwell that future installment payments from loan proceeds would be conditioned and dependent upon furnishing satisfactory lien waivers for labor and material to said property in order to determine that the loan proceeds were in fact used for the improvement of the subject premises. Plaintiffs admits encouraging Tidwell to complete the improvements, but denies promising payment to Tidwell or anyone in the capacity of a sub-contractor unless and until satisfactory lien waivers were furnished."

From Appellant's answers it is obvious that the Appellant knew that Tidwell was in financial difficulty and he was in default in his performance under the terms of the Disbursement Agreement, for he had failed to produce lien waivers, work had ceased for more than 15 days, more than eight months had elapsed and construction was not complete and a notice of lien had been filed against the property. The Court should take notice of the fact that the Appellant in its Complaint alleges a lien filed by a Frank Lewis, which lien is a matter of record, having been recorded on the 12th day of January, 1967, four months before the Respondent's work on the house commenced (R-2). Yet, knowing all this, Appellant still en-

couraged Tidwell to go in and complete the construction of the house, and the Court should note that he Respondent's evidence is that Tidwell was not only encouraged but was instructed to go in and finish the work (R-33). Tidwell then contacted the Respondent (Bailey) and stated to him that there was sufficient money to pay for the work and the Mortgagee was holding the same (R-36). On the representation of Tidwell, who was induced by the Appellant, the Respondent did accept the job and on the 16th day of May, 1967, unjustly enriched the property by providing labor and material in the sum of $1,990.70.

The Supreme Court of Missouri, in the case of Magidson vs. Stern, 148 SW2d 144, in holding that a prior mortgage has priority over mechanic's liens, unless the holder of such mortgage has waived his priority, held:

> "The rule in such matters is that while the mortgagee does not waive the priority of his lien by merely consenting or failing to object to the improvements (Bovard vs. Owen, Mo. App., 30 S.W. 2d 154), yet he may, by reason of inducing the furnishing of the labor and materials, be precluded from asserting the priority of his mortgage over a mechanic's lien." Compton v. Conrad, 203 Mo. App. 211, 209 SW 288; 4 C.J. 299.

Also, in the case of Bedford Lake Park Corp. v. Twelve Linden Corporation, et al, 190 N.Y. S. 2d 834, where the Court stated:

> "In our opinion there is an issue of fact as to whether the materials were delivered by Appellant "with the consent or at the request of" Respondent. And, if appellant establishes its contention that respondent induced delivery of the material, respondent would be estopped from asserting that its mortgage is prior and superior to appellant's lien." (Ash v. Honig, 62 F2d 793,

Certiorari denied sup nom. Suffern Nat. Bank & Trust Co. vs. Ash 288 U.S. 614, 53 S Ct. 405, 77 L. Ed. 988).

When Respondent attempted to collect his money, he was told by Tidwell that he, Tidwell, had instructed the Mortgagee to pay him, but the Mortgagee refused to make payment even after being so instructed. At no time did the Mortgagee, nor did Tidwell, ask that lien waivers be produced. The Respondent has now produced a lien waiver which is on file with the Court (R-35).

The law in Utah is well settled that a Mortgagee is obligated to pay out money, according to the instructions of the Mortgagor and if it fails to do so, then the prior recorded mortgage would not have priority over a mechanic's lien to the extent of the money advanced. For this Court held in the case of Utah Savings & Loan vs. Mecham, *supra*:

> "A mortgagee who is loaning money to a mortgagor borrower, is obligated to pay out money in accordance with the directions of the borrower. This is especially so where as in the instant case a sum certain is stated in the mortgage and no provisions are made for the future advances."

See, also, Western Mortgage Loan Corp. v. Cottonwood Construction Co., 42 P2d 437.

The Respondent did, on or about the 15th day of July, 1967, have numerous conversations with Elmer Davis, the Vice President of the Appellant Corporation, and Mr. Davis did assure the Respondent that there were sufficient funds to pay the bills and to finish the home and that if Tidwell was not going to finish it, that they were trying to work out arrangements with other builders but, again, Appellant did not ask for a lien waiver nor did the

Respondent refuse to give one (R-21, 36). All this was taking place after the Mortgagee had paid out $11,600 to Tidwell, with the last payment being made on November 1, 1966, without receiving any lien waivers of any sort and, also, at this time, the incomplete building loan account was still intact and the money was still present to be disbursed to those who had worked on the premises (R-31). The case before the Court in a prime example of the situation Chief Justice J. Allen Crockett refers to in his concurring opinion in the case of Western Mortgage Loan Corp. vs. Cottonwood Construction Co., 42 P2d 437. The case involves the relative priorities of mechanic lienors and a construction mortgage. The Defendant construction company received a construction loan from the Plaintiff, Western Mortgage Loan Corporation. The mortgage document provided for obligatory or non-volitional advances and the Plaintiff contends that such advances take priority as of the time of the recording of the mortgage, with the Defendants contending otherwise. The Court stated:

> "Under the construction loan agreement Western was obligated to pay out the funds as the building progressed. We are of the opinion that the agreement to disburse the funds created an obligation on the part of the lender to pay over the funds in accordance with the borrower's direction."

Chief Justice, Crockett, in concurring, provided:

> "I agree that under the facts as disclosed in this case a mortgage for a definite amount, which is recorded prior to the attachment of any lien rights, should under normal circumstances take preference up to the amount that is paid out under the terms of the recorded mortgage agreement.

> But I desire to note that there may be situations in which the lending institution is holding money not yet advanced on a building lot, when it acquires actual knowledge that the builder is diverting money to some other purpose and knows that the laborers or materialmen are not being paid and will not be paid. Under such circumstances the financier certainly should not be permitted to go on paying the money to a builder and thus in effect assist in cheating the laborers and materialmen out of their pay and preclude them from the right to lien protection".

The Appellant is taking an inconsistent position, in that, on the one hand they allege that the agreement was breached by the Defendant, (Tidwell) failing to produce lien waivers and, therefore, their prior recorded mortgage takes priority over mechanic's liens for the extent of the money advanced. But, on the other hand, when it advanced monies without receiving the necessary lien waivers, then its own negligence in advancing the money precludes it from asserting that its mortgage would take priority over a subsequent filed mechanic's lien. In the case of Falk Lumber Company, vs. Heman, 183 N. E. 2d 265, the mechanic's lien holders filed action against the home owner who filed a cross petition against the mortgagee. The home owner, mortgagor, charges that the mortgagee was negligent in the distribution of the funds. The Court found that the mortgagee relied on the reputation of the builder and disbursed the funds in a negligent manner without receiving instructions from the home owner. The Court held that the mortgagee bank was negligent and that the home owner should have a judgement against the bank in the amount of the mechanic's lien. See, also 7th Decennial Digest Mortgages, Secs. 182-185 p. 74-75.

CONCLUSION

Appellant had a duty to take affirmative action, to prevent the Respondent from providing labor and material in the construction of the house, thereby enhancing the value of the house and unjustly enriching the Appellant. Especially, is this true, when a notice of lien was filed against the property four months before the Respondent commenced working on the house and $11,600 was paid out without any lien waivers being received, with the last payment being made five and one-half months before Respondent went into the house. In view of Tidwell's apparent breach of the Disbursement Agreement, the Appellant had the duty to declare the Agreement in default, to close out the loan account, to stop construction and to prevent further sub-contractors from putting labor and material into the house. However, the Appellant kept he Agreement open, inducing the Respondent to rely upon the same. The Appellant's actions and failure to act would estop it from asserting that its prior recorded mortgage would take priority over Respondent's Mechanic's Lien.

The decision of the Lower Court should be affirmed.

Respectfully submitted,

Homer Wilkinson
Atty. for Respondent